



# **Federal Housing Finance Board**

## **Strategic Plan**

### **Fiscal Years**

**2003-2008**

**Amended and Updated through  
August 31, 2004**

## **MESSAGE FROM THE CHAIRMAN**

Two years ago the Federal Housing Finance Board (“Finance Board”) embarked on a long-term, disciplined program to improve its oversight of the Federal Home Loan Banks (“FHLBanks”), twelve large and increasingly complex government-sponsored enterprises that play an important role in the nation’s system of housing finance. A strategic plan covering fiscal years 2003 through 2008 (“February 2004 Strategic Plan”) resulted from that effort and was unanimously adopted by the Board of Directors of the Finance Board on February 18, 2004. The strategic plan now before you incorporates amendments and updates to the February 2004 Strategic Plan through August 31, 2004. Like the February 2004 Strategic Plan, the strategic plan before you reflects continued dedication to the agency’s program of improvement, a commitment shared by all of the directors of the Finance Board and the agency’s personnel.

The Finance Board’s ongoing transformation into an arm’s-length financial regulator has been accomplished through numerous significant and well-planned changes in the agency’s operations and philosophy. Additional staff and resources were made available for safety and soundness oversight, and examinations of the FHLBanks became more thorough and rigorous. Examinations now acknowledge the reality that banking is a business of managing risks, and the responsibility of bank supervisors is to ensure the institutions they regulate understand those risks, and that they monitor and control them through prudent risk management practices.

The progress so far attests to the utmost seriousness with which the Finance Board carries out its statutory duties, as captured in the Mission Statement on page four of the Strategic Plan: “The mission of the Finance Board is to ensure that the FHLBanks are safe and sound so they can serve as a reliable source of liquidity and funding for the nation’s housing finance and community investment needs.”

Seriousness of purpose also imbues the Strategic Plan, which provides a framework for further improvement of the Finance Board’s regulatory and oversight capabilities. Through the document, the Finance Board affirms its dedication “to the highest professional standards of accountability and independence in order to carry out its responsibilities for bank supervision and housing finance mission oversight” so as to “continue to earn the public’s trust.”

This vision and accompanying values – independence, accountability, responsiveness, integrity, and excellence – will serve the Finance Board well in the face of ongoing, rapid change in the world of finance and regulation of government-sponsored enterprises. Brought into practice by a dedicated professional staff, this vision and these values will also ensure that the FHLBanks remain well regulated.

Above all, by helping to fulfill the mission reflected in this Strategic Plan, the vision and values of the Finance Board will protect a public that depends on the FHLBanks as an integral part of the nation’s housing-finance system, the very same public that stands behind the FHLBanks as institutions chartered by the federal government.

Alicia R. Castaneda  
Chairman

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## **Introduction**

### ***The Federal Housing Finance Board***

The Federal Housing Finance Board (“Finance Board”) is an independent federal agency established by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (“FIRREA”). The Finance Board is charged with supervising and regulating twelve Federal Home Loan Banks (“FHLBanks”) and has the statutory duty to ensure that the FHLBanks operate in a financially safe and sound manner, are adequately capitalized, and able to raise funds in the capital markets. The Finance Board also has the statutory duty to ensure that the FHLBanks carry out their housing finance mission.

The Finance Board is the successor to the former Federal Home Loan Bank Board (“FHLBB”), which had been established by the Federal Home Loan Bank Act of 1932 (“FHLBank Act”). The Finance Board’s board of directors comprises five members -- four are appointed by the President and confirmed by the Senate, all of whom must have extensive experience or training in housing finance or a commitment to providing specialized housing credit. The fifth member is the Secretary of the U.S. Department of Housing and Urban Development. Not more than three directors can be from the same political party. At least one appointed director must be from an organization with more than a two-year history of representing consumer or community interests in banking services, credit needs, housing, or financial consumer protections. The appointed members of the Board of Directors serve staggered seven-year terms. The President designates the chairperson of the Board of Directors from among these appointed members.

The Finance Board draws its financial resources from assessments on the twelve FHLBanks. It receives no appropriations and its funds are not subject to apportionment.

### ***The Federal Home Loan Banks***

In 1932, the Congress directed the FHLBB to establish between eight and twelve FHLBanks to stimulate mortgage financing and provide liquidity to credit markets that had been adversely affected by the Great Depression. For many decades, members of the FHLBanks consisted primarily of savings and loan associations engaged in home financing; federally chartered savings and loan associations were required by statute to be members. State chartered savings and loan associations were required to be FHLBank members by agreement with the Federal Savings and Loan Insurance Corporation as a condition to obtaining federal deposit insurance. However, in FIRREA, Congress extended eligibility for FHLBank membership to commercial banks and to federally insured credit unions (subject to a home financing requirement). In FIRREA, Congress also established several FHLBank community investment programs. With the enactment of the Gramm-Leach Bliley Act in 1999 (“GLB Act”), Congress repealed the mandatory membership requirement for federal savings associations. FHLBank membership is now voluntary for all types of eligible institutions.

The FHLBanks, each of which operates within a multi-state district, are located in Boston, New York, Pittsburgh, Atlanta, Cincinnati, Indianapolis, Chicago, Des Moines, Dallas, Topeka,

San Francisco, and Seattle. The FHLBanks, along with the Office of Finance (“OF”) of the FHLBanks, are collectively referred to as the “Federal Home Loan Bank System” (“System”). OF issues debt known as “consolidated obligations” in the capital markets on behalf of the FHLBanks. In addition, OF prepares and issues combined quarterly and annual financial reports for the FHLBanks. As of June 30, 2004, the FHLBanks had combined assets approaching \$900 billion.

A board of directors governs each FHLBank. Each FHLBank’s members elect a majority of the directors to serve on the board and the Finance Board appoints a minority of the directors. The FHLBank Act requires that at least two of the appointed directors be chosen from organizations with more than a two-year history of representing consumer or community interests on banking services, credit needs, housing, or financial consumer protections. Although each FHLBank is a separate corporate entity with its own management and board of directors, the FHLBanks are jointly and severally liable for all System consolidated obligation debt.

Membership in an FHLBank is limited to commercial banks, savings institutions, credit unions, and insurance companies that meet eligibility criteria. The FHLBanks’ combined membership exceeds 8,000 institutions. Only FHLBank members and non-member housing associates (principally state and local housing finance agencies) can borrow from an FHLBank. The benefits of membership flow through access to low-cost funds known as advances (collateralized loans), which a member uses to fund mortgage loans and to maintain liquidity for its operations, as well as through dividends paid on member-owned capital stock. The preponderance of the collateral supporting advances consists of mortgage assets.

A significant business activity of the FHLBanks is to provide advances to their financial institution members. Access to FHLBank advances enables lenders to hold lesser amounts of low-yielding liquid assets than they otherwise would need to hold. The FHLBank Act stipulates that a member may use long-term advances only to support residential housing finance and, in the case of a community financial institution, to support lending to small businesses, small farms, and small agricultural businesses.

In addition to advances, all FHLBanks offer mortgage purchase programs in which they buy qualifying mortgage loans from members. Under these programs, the FHLBank manages the market risk associated with the loans, while the member bears most of the credit risk (either directly or indirectly through the purchase of mortgage insurance for the loans sold to the FHLBank).

Members have access to a broad array of community investment advances and grants to support affordable housing and community investment initiatives. The FHLBank Act requires each FHLBank to allocate ten percent of its prior year’s net income to fund a subsidy program known as the Affordable Housing Program (“AHP”). Under the terms of the AHP, a member may submit an application to its FHLBank for funds to be used to finance housing for very low-, low-, and moderate-income households. As of June 30, 2004, the FHLBanks have committed approximately \$2 billion in AHP subsidies to their members since 1990.

The FHLBanks fund themselves principally by issuing consolidated obligations of the System in the public capital markets through OF, which acts as the FHLBanks’ agent. Consolidated obligations of the System consist of bonds (original maturity of one year or longer) and discount notes (original maturity of less than one year). Consolidated obligations are not

guaranteed or insured by the federal government. However, the FHLBanks' government-sponsored enterprise status accords certain privileges and enables the FHLBanks to raise funds at rates slightly above comparable obligations issued by the U.S. Department of the Treasury.

## **Key External Factors**

As is the case with all financial institution regulators, the Finance Board is affected by macroeconomic conditions. The Finance Board cannot control such factors as the capital markets, interest rates, regional or national recessions or economic expansions, housing prices, financial industry consolidation and restructuring, or banking policies formulated beyond its own jurisdiction.

The ability of the FHLBanks to provide funds to their members by issuing consolidated obligations can be affected by such factors as adverse movements in the international capital markets (such as a major foreign debt crisis), developments affecting the other government sponsored enterprises, political factors, and unforeseen events. The FHLBanks' debt must compete against such alternative investments as securities issued by the U.S. Department of the Treasury, other government-sponsored enterprises, and foreign or domestic corporate issues.

The FHLBanks operate in an environment characterized by changing financial markets. With the advent of the revolutionary changes in information technology, financial markets move more rapidly than ever before. In recent years, the role of the FHLBanks as financial intermediaries has changed considerably and has grown in complexity as innovative financial products and risk management techniques are used to improve the management and control of risk. Moreover, consolidation of the financial services industry has presented challenges to the System as it has realigned the System's membership base.

In a competitive financial services environment where highly skilled personnel are in great demand, a key challenge before the Finance Board will be to retain a highly competent work force and, as needs dictate, to attract additional highly qualified bank examination and supervision staff with the requisite financial and technological skills to model, monitor, and assess the risks undertaken by the FHLBanks. The Finance Board will also need to evaluate on an ongoing basis the reliability of its own and the FHLBanks' financial models to assure that they adequately measure the FHLBanks' market risk.

## **The Finance Board's Mission, Vision, and Values**

### ***Mission Statement***

The mission of the Finance Board is to ensure that the FHLBanks are safe and sound so they can serve as a reliable source of liquidity and funding for the nation's housing finance and community investment needs.

### ***Vision and Values***

**Vision:** To continue to earn the public's trust, the Finance Board is dedicated to the highest professional standards of accountability and independence in order to carry out its responsibilities for bank supervision and housing finance mission oversight.

**Values:** The core values underlying the mission and vision of the Finance Board, which guide its organizational decisions and actions, are:

- **Independence.** The Finance Board is the arm's-length regulator of the FHLBanks and OF.
- **Accountability.** The Finance Board is a steward of the public's trust and will use its resources efficiently and in the public interest.
- **Responsiveness.** The Finance Board aligns its actions with its mission and responds promptly, effectively, and creatively to emerging risks and opportunities in the financial system .
- **Integrity.** The Finance Board discharges its responsibilities fairly and impartially and adheres to the highest standards of ethical conduct.
- **Excellence.** The Finance Board strives for excellence in carrying out its responsibilities and recognizes the contributions of employees who demonstrate the highest professional standards in their work.

## **The Finance Board's Strategic Goals**

The Finance Board has identified three strategic goals in supporting achievement of the agency's mission. These strategic goals are:

***Strategic Goal 1:*** The Finance Board's program of bank supervision fosters safe and sound operations at each of the FHLBanks.

***Strategic Goal 2:*** The Finance Board ensures that the FHLBanks serve the nation's housing finance and community investment needs.

***Strategic Goal 3:*** The Finance Board's supervisory, managerial, and legal resources support effective, efficient, and responsive bank supervision and regulation and housing mission oversight.

On the pages that follow, each strategic goal has been laid out and strategic objectives identified. These strategic objectives serve as the framework for the achievement of the agency's mission. The means and strategies to achieve these objectives have also been identified, as have general performance measures, which will be used to establish the annual performance goals for the agency during each annual planning period.



## **STRATEGIC GOAL 1: The Federal Housing Finance Board’s Program of Bank Supervision Fosters Safe and Sound Operations at Each of the Federal Home Loan Banks.**

<b>Strategic Objective 1.1: The Federal Home Loan Banks Operate Safely and Soundly.</b>
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### **Means and Strategies:**

#### **1.1.1. Carry Out an Effective, Risk-Based Examination Program.**

- Designate examiners-in-charge (“EICs”) for each FHLBank and OF who will be assigned the principal supervisory responsibility.
- Develop supervisory strategies and set the scope of examinations on the basis of risk.
- Conduct an annual on-site examination of each FHLBank and OF.
- Communicate supervisory concerns promptly to each FHLBank and OF.
- Apply statutory and other appropriate remedies for concerns warranting supervisory action.
- Communicate quarterly, or more frequently where warranted, with each FHLBank and OF to follow up on significant supervisory issues.
- Conduct system-wide reviews of the effectiveness of key FHLBank operational, governance, and other practices.
- Recruit, train, and retain dedicated examination staff.
- Review the FHLBanks’ applications for new business activities and provide an assessment of their implications.
- Augment examination staff with economists, accountants, analysts, and other professional staff.

#### **1.1.2. Enhance Examination Support Program Through Increased Examiner Guidance and Training.**

- Develop a bank-wide risk assessment framework and risk-focused examination manual.
- Provide supplemental examiner guidance in response to emerging issues.
- Augment examiner training and development to enhance knowledge and skills.
- Develop a quality assurance program to assure that high examinations are consistently

achieved.

- Evaluate practices of other financial institution regulators for effectiveness and integration into Finance Board examination practices.

#### **1.1.3. Enhance the Finance Board's Risk Modeling Tools and Resources.**

- Enhance the Finance Board's risk modeling tools. Estimate market risk for each FHLBank quarterly.
- Evaluate risk modeling and management practices of other financial institution regulators and financial institutions as a benchmarking tool.
- Recruit, train, and retain staff with technical capabilities to assess market risk.
- Provide technical support to examiners on market risk through modeling and analysis.

#### **1.1.4. Enhance the Finance Board's Off-Site Risk Monitoring Capacity.**

- Maintain an effective FHLBank analyst program.
- Collect and evaluate FHLBank financial data.
- Recruit, train, and retain staff with technical capabilities to develop additional risk monitoring tools.
- Provide technical support to examiners through monitoring resources and tools.
- Evaluate risk monitoring tools of other financial institution regulators for integration into the off-site risk monitoring program.

The FHLBank Act charges the Finance Board with the primary duty “to ensure that the Federal Home Loan Banks operate in a financially safe and sound manner.” The Finance Board carries out that charge by conducting comprehensive on-site examinations at each FHLBank and OF at least annually. As warranted, the Finance Board also conducts systemwide, or horizontal, reviews of significant FHLBank operational, governance, and other practices. An off-site monitoring program and risk modeling initiatives complement on-site examinations. Supervisory guidance conveyed through advisory bulletins and regulatory interpretations address supervisory issues with System-wide implications.

The FHLBanks face credit, market, and operational risk. To manage these risks, the FHLBanks must identify and quantify the risks, adopt and implement appropriate risk management policies and procedures, and maintain strong corporate governance, a sound system of internal control, an independent internal audit function, and comprehensive management reporting.

The on-site examinations are risk-focused. In performing the pre-examination analysis and routine quarterly monitoring, the EIC identifies potential issues on the basis of risks and conditions identified at previous examinations, as well as through quarterly monitoring and other means, and

sets the scope for the examination on the basis of identified risks. Examinations focus on risk areas, such as market risk (including interest rate risk), credit risk, and operational risk.

While on site, examiners: (i) follow up on issues from the previous examination and issues identified during the pre-examination and quarterly monitoring reviews; (ii) test systems, controls, and reports for adequacy and accuracy, including the internal audit function; (iii) assess the FHLBank's risk level and operational soundness; (iv) identify issues that may affect the risk or operating profile of the FHLBank; (v) evaluate financial condition and performance; (vi) evaluate the quality of corporate governance by the FHLBank's board of directors and management; and (vii) test for compliance with laws, regulations, internal policies of the FHLBank, and policies of the Finance Board. As needed, consult with the Finance Board's examiners, attorneys, accountants, economists, and analysts regarding issues within their areas of competence.

At the conclusion of the on-site review, examiners hold an exit conference with FHLBank management to discuss findings. Management is given the opportunity to respond to examination findings, as well as to commit to corrective action where appropriate. A written report of examination is prepared for presentation to the FHLBank's board of directors based on examiners' findings and management's response. Findings are categorized by degree of severity from "recommendation" to "unsafe and unsound practice or condition." In addition, the report of examination identifies apparent violations of statute and regulation. Following the presentation to the FHLBank's board of directors, the board is asked to respond to the findings and conclusions in the report of examination. After conclusion of the examination, the EIC conducts follow-up discussions with the FHLBank on a quarterly or more frequent basis, to monitor its progress in remedying weaknesses and violations identified during the examination. Generally, the FHLBanks have voluntarily addressed examination findings. However, the agency, under the FHLBank Act, has the power to issue and enforce supervisory orders as necessary to carry out its responsibilities.

An examination survey is made available to the president of the FHLBank examined at the conclusion of the examination. This survey is considered part of the supervisory program and is designed to elicit feedback on the quality of the examination.

To enhance the examination program, the Finance Board is developing a bank-wide risk assessment framework that will be incorporated into a revised examination manual. The examination manual will include work programs for the individual FHLBank operations and activities. These documents will articulate the risk-focused approach the Finance Board expects its examiners to use in conducting examinations.

The Finance Board continues to recruit high caliber, experienced examiners to provide for more continuous monitoring and expanded reviews. The Finance Board encourages examiners to supplement their experience with additional training and certification programs, such as the Chartered Financial Analyst and Financial Risk Manager certifications.

The Finance Board employs quantitative methods and computer models to support its annual examination function in the area of market risk measurement and modeling. The agency uses a variety of vendor models to measure risk factors affecting each FHLBank, including changes in interest rates and interest rate spreads, as well as interest rate volatility. The agency typically calculates a variety of market risk measures, including duration, convexity, and spread duration. In addition, the quality of the market risk model used by each FHLBank and the FHLBank's ability to

respond to changing market and economic circumstances are also assessed. The market risk component of each FHLBank's risk-based capital requirement under the Finance Board's regulations is based upon a Value-at-Risk calculation conducted by the FHLBank.

The Finance Board is developing a standardized market risk data collection system that will result in improved data integrity and consistency across the System. This system will allow the agency to better measure and monitor the market risk exposure of individual FHLBanks and for the System as a whole, and do so in a uniform and timely manner. The Finance Board has also commenced the development of an enterprise-wide risk management system which will permit the agency to calculate market exposures for the agency as a whole on a quarterly basis and to produce quarterly risk exposure reports for each FHLBank. Risk exposure calculations included in the reports will include such measures as duration, convexity, spread duration, and Value-at-Risk. Such reporting will also be compared with measurements reported by each FHLBank; any discrepancies present could indicate potential examination issues and provide a basis for discussions designed to reconcile these differences.

In addition to risk modeling, an analyst is assigned to work with the EIC in identifying and assessing risks at an individual FHLBank. The analyst monitors the on-going activities and financial performance of his or her assigned FHLBanks between examinations. Other staff, including accountants, attorneys, and economists provide technical assistance to the examiners.

The Finance Board's risk monitoring unit is responsible for maintaining the agency's databases and systems, such as the Finance Board Call Report System. This unit provides support to examiners and the risk modeling staff in developing and employing tools, processes, and reports that support and enhance the Finance Board supervisory program. The risk monitoring unit is also responsible for identifying and reporting risks resulting from FHLBank operations or the markets in which they operate.

<p><b>Strategic Objective 1.2: The Federal Home Loans Banks Meet or Exceed Their Minimum Capital Requirements.</b></p>
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**Means and Strategies:**

**1.2.1. Assess Capital of Each FHLBank for Adequacy and Legal Compliance.**

- Collect and monitor capital data from each FHLBank.
- Disseminate regulatory and supervisory guidance with respect to capital sufficiency and composition in light of Basel II, risk-based capital standards, and total capital requirements.
- Apply statutory, regulatory, and other appropriate remedies to an FHLBank with insufficient capital.
- Require the FHLBanks to assess the adequacy of their retained earnings and review

these assessments as part of the annual examination.

### **1.2.2. Evaluate Each FHLBank's Implementation of Its Capital Structure Plan.**

- Assess, at least annually, the adequacy of each FHLBank's internal market risk model.
- Assess, at least annually, the adequacy of each FHLBank's risk assessment procedures and controls.
- Monitor each FHLBank's capital plan implementation progression.
- Take action on any FHLBank's capital plan amendment requests.
- Conduct review of proposed FHLBank market risk models or cash-flow models and risk assessment procedures and controls.

In 1999, through the passage of the GLB Act, new capital rules were established for total capital and risk-based capital. Prior to the GLB Act, any member of an FHLBank, except for a federally chartered thrift, was allowed to withdraw its membership and redeem its stock in the FHLBank with a six-month notice. A federally chartered thrift was not allowed to withdraw from membership. The GLB Act made membership voluntary for federally chartered thrifts and established the framework for a new capital structure at each of the FHLBanks. Under the new capital structure, an FHLBank may issue two classes of capital stock, both redeemable by the member at par. Class A stock is redeemable with a six-month notice. Class B stock is redeemable with a five-year notice. However, in no case may an FHLBank redeem capital stock if, following the redemption, the FHLBank would fail to satisfy any minimum capital requirement.

The FHLBank Act establishes a minimum leverage requirement (total capital/total assets) of five percent. To meet the leverage ratio, the paid-in value of outstanding class B stock and retained earnings are multiplied by 1.5; however, an FHLBank's total capital (without taking into account the multiplier) must not be less than four percent of the total assets of the FHLBank.

In addition, the FHLBank Act imposes risk-based capital requirements on the FHLBanks in accordance with Finance Board regulations that reflect the institution's market, credit, and operations risks. In early 2001, the Finance Board finalized its capital rules which require an FHLBank to maintain permanent capital in an amount at least equal to the sum of its credit risk, market risk, and operations risk capital requirements. In addition, the regulations state that, for purposes of safety and soundness, the Finance Board may require an FHLBank to maintain a greater amount of permanent capital.

The FHLBanks were required to submit to the Finance Board by October 29, 2001, a plan to establish and implement a new capital structure. By July 2002, the Finance Board had approved all of the FHLBanks' capital plans. Before each FHLBank can implement its capital plan, however, the Finance Board must approve the FHLBank's internal market risk model or cash-flow model and its risk assessment procedures and controls to be used in managing its credit, market, and operations risk. The Finance Board must also approve any changes proposed each FHLBank to an internal risk model or internal cash-flow model that has already received agency

approval.

Each FHLBank that has not implemented its capital structure plan must adhere to an alternative leverage requirement until plan implementation occurs and compliance with the total capital and risk-based capital requirements can be achieved. The total assets of each FHLBank subject to this requirement may not exceed twenty-one times the total of the institution's paid-in capital stock, retained earnings, and reserves (excluding loss reserves and liquidity reserves for deposits) except under certain circumstances. Each such FHLBank must also maintain capital stock equal to the greater of five percent of advances or one percent of member mortgage assets.

The Finance Board also plans to review periodically its capital regulations and the capital position of each FHLBank. Included in this review will be an assessment of the adequacy of the FHLBanks' retained earnings under various market scenarios. The Finance Board will also monitor emerging issues such as the proposed revisions to the bank supervisory standards developed by the Basel Committee in Basel II, as applicable to the FHLBanks.

<p><b>Strategic Objective 1.3: The Federal Home Loan Banks Raise Funds in the Capital Markets Efficiently and Are Role Models for Corporate Transparency and Accountability.</b></p>
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**Means and Strategies:**

**1.3.1. Evaluate the FHLBanks' Ability to Raise Funds Efficiently.**

- Conduct comparative review and assessment system of System funding costs on a semi-annual basis.
- Monitor the rating on consolidated obligations of the System (to be triple-A).
- Monitor the rating of each FHLBank (to be no less than double-A).

**1.3.2. Review Each FHLBank's and the System's Financial Disclosures for Regulatory Compliance.**

- Review combined annual and quarterly reports and individual FHLBank disclosures for compliance with regulatory requirements.
- Review and test OF policies and procedures.
- Disseminate regulatory and supervisory guidance regarding financial disclosure to ensure the FHLBanks meet or exceed SEC-based disclosure requirements and to assist each FHLBank in the registration of a class of its equity securities with the SEC under Section 12(g) of the Securities Exchange Act of 1934.

The Finance Board has a statutory duty to ensure that the FHLBanks remain able to raise funds in the capital markets. By regulation, the FHLBanks must take appropriate actions to preserve the System's triple-A rating on consolidated obligations. The regulation requires the FHLBanks to maintain a risk profile that results in the highest rating from any nationally

recognized statistical rating organization for the FHLBanks' consolidated obligations.

To measure the FHLBanks' efficiency in raising funds in the capital markets, the Finance Board conducts a semi-annual review of the FHLBanks' relative funding costs. The FHLBanks' status as government-sponsored enterprises enables the FHLBanks to raise funds in the capital markets at rates slightly above those of obligations of the U.S. Department of the Treasury of similar maturity. The Finance Board monitors the difference, or spread, between the FHLBanks' cost of funds and the cost of funds of the U.S. Department of the Treasury.

In addition to this spread comparison, the Finance Board compares the spread between FHLBank consolidated obligations and those of comparable type and similar maturity issued by Fannie Mae and Freddie Mac. This measure is used because the basis or spread between Treasury obligations and agency obligations may reflect factors not under the control of the agencies.

The Finance Board expects the FHLBanks to be role models for transparency in the marketplace. Purchase terms for FHLBank consolidated obligations are specified in a master underwriting agreement. Dealers are required to sell consolidated obligations only to investors who have knowledge and experience in financial and business matters and who are capable of evaluating the merits and risks of the prospective investment. The master underwriting agreement requires the underwriter to provide individual investors with disclosure information such as annual financial reports, offering notices, and offering circulars. Each underwriter must annually conduct a review of its compliance with the provisions in the agreement.

To enforce these provisions, the FHLBanks' OF conducts an annual compliance review of the dealers' actions. In its annual on-site examination of OF, the Finance Board tests for compliance with law, regulation, and OF internal policy, including policies requiring the maintenance by participating underwriters and broker-dealers of satisfactory sales suitability practices.

Investor confidence in the System is essential for the FHLBanks to raise funds effectively in the capital markets and fulfill their housing finance mission. Therefore, financial disclosures should be sufficiently transparent that investors have full confidence in the reliability of the System's financial reports. To this end, the Finance Board reviews the FHLBanks' combined annual and quarterly reports and individual FHLBank's disclosures. The reviews assess consistency of the reports with the requirements of the Finance Board's regulations, conformity with generally accepted accounting principles, and transparency. As effective practices are identified, the Finance Board will disseminate supervisory guidance and interpretations and promulgate additional regulations. The Finance Board intends to supplement its existing staff with additional accountants.

In June 2004, Finance Board adopted a regulation requiring each FHLBank to register a class of its equity securities with the Securities and Exchange Commission ("SEC") under Section 12(g) of the Securities Exchange Act of 1934 ("1934 Act"). By registering a class of equity securities with the SEC under Section 12(g), each FHLBank will become subject to the 1934 Act's periodic disclosure regime, as interpreted and administered by the SEC. That disclosure regime includes the periodic preparation and filing of public disclosures relating to an institution's financial condition, results of operations, trends or uncertainties affecting its business, and management's assessment of its business and financial condition that includes supporting financial information and certifications. These disclosures will be filed with the SEC as well as with the Finance Board on a concurrent basis. The preparation and issuance of Bank System Combined

Reports will continue to be regulated by the Finance Board, in consultation with the SEC, but will not be subject to SEC disclosure or filing requirements. However, OF, in preparing and issuing, and the agency, in reviewing, the Bank System Combined Reports will have the benefit of the periodic disclosure documents filed by the FHLBanks pursuant to the 1934 Act, reviewed by SEC staff. Each FHLBank is required to file a registration statement covering a class of equity securities with the SEC by June 30, 2005 and ensure its effectiveness under Section 12 of the 1934 Act by August 29, 2005.

## **STRATEGIC GOAL 2: The Federal Housing Finance Board Ensures that the Federal Home Loan Banks Serve the Nation's Housing Finance and Community Investment Needs.**

<b>Strategic Objective 2.1: The Federal Home Loan Banks Facilitate the Housing Finance Activities of Their Members.</b>
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### **Means and Strategies:**

#### **2.1.1. Monitor Each FHLBank's Advance Portfolio.**

- Ensure advance and collateral activities meet statutory and regulatory standards.
- Monitor quarterly the composition and size of each FHLBank's advance portfolio.
- Assess disclosures and marketing of each FHLBank's putable or convertible advance products.
- Review development of new advance products for safety and soundness, compliance with law and regulation, and responsiveness to member needs.
- Respond to new business activity notices involving advance activities within sixty days of receipt.

#### **2.1.2. Monitor Each FHLBank's Acquired Member Asset ("AMA") Portfolio.**

- Ensure AMA activities meet statutory and regulatory standards.
- Assess disclosures and marketing of each FHLBank's AMA products.
- Assess the effectiveness of alternative AMA structures in supporting housing finance.
- Review development of new AMA products for safety and soundness, compliance with law and regulation, and responsiveness to member needs.



- Respond to new business activity notices involving AMA activities within sixty days of receipt.
- Collect and analyze certain demographic and other information regarding mortgages under the AMA programs at least annually.

Among the statutorily prescribed duties of the Finance Board is a mandate to “(E)nsure that the Federal Home Loan Banks carry out their housing finance mission.” Congress has articulated the FHLBanks’ mission through a series of interdependent provisions within the FHLBank Act. These statutory provisions establish standards for: (i) eligibility for membership in the System; (ii) FHLBank advances; (iii) assets eligible to be pledged as collateral for an advance; (iv) authorized FHLBank investments; and (v) prescribed community investment programs.

The Finance Board promulgates regulations with the intent of facilitating the flow of housing capital and the effectiveness of the FHLBanks as conduits in serving the nation’s housing finance needs. The Finance Board also monitors activity level and portfolio composition of the FHLBanks to observe the extent to which the FHLBanks facilitate the housing finance activities of their members, and, through their members, serve the nation’s housing finance and community investment needs.

### *Advances*

One way in which the FHLBanks meet their housing finance mission is through the issuance of advances to their members and housing associates. Advances account for more than sixty percent of FHLBank assets.

The Finance Board has a responsibility to establish standards so that FHLBank members are provided with consistent, fair, and transparent access to advances and to monitor the FHLBanks for adherence to the public purpose safeguards in the FHLBank Act and regulations governing advances.

The FHLBank Act requires that advances be fully collateralized by a member’s assets and identifies the specific types of assets that may be pledged as collateral, most notably, fully disbursed, whole first mortgages on improved residential property. In 1999, as a means to encourage member community financial institutions’ access to advances, Congress permitted these institutions to pledge loans to small businesses, small farms, and small agricultural businesses as collateral for advances.

Finance Board examiners evaluate each FHLBank’s advance and collateral policies as part of their annual FHLBank examinations. The Finance Board also conducts periodic off-site monitoring reviews. To monitor trends on advance activity and volumes, the Finance Board monitors the size and composition of each FHLBank’s advance portfolio on a quarterly basis.

The Finance Board’s supervisory team will review each FHLBank to ensure that its practices are consistent with the statute and regulations governing advances and collateral. This assessment includes the review of the use of advances and collateral pledged by community financial institutions. Finance Board examiners will also review each FHLBank’s standards and criteria for differential pricing of advances and collateral valuation.

The annual examinations include a review of FHLBank practices in marketing and disclosure of advance products to assure transparency in the terms and conditions of the advances. This assessment includes a review of the marketing and disclosure of risks inherent in advances with embedded options, such as putable or convertible advances.

An FHLBank must file a new business activity notice with the Finance Board for collateral or advance activities that entail new risks. The Finance Board has in place review procedures to ensure that these notices, in addition to safety and soundness considerations, are assessed within the context of an FHLBank's housing mission and conducted on a timely basis to permit the FHLBank to take advantage of appropriate market opportunities.

### ***Acquired Member Assets***

The FHLBanks are authorized to purchase certain assets that are referred to as Acquired Member Assets ("AMA") under Finance Board regulations. Under the AMA regulation, the FHLBanks may purchase mortgage assets held or originated by FHLBank members and housing associates. The AMA programs make up more than ten percent of System assets. AMA assets are acquired by FHLBanks pursuant to FHLBank-sponsored programs under which the FHLBanks fund or acquire mortgage assets from a member institution or housing associate through a risk structure that allocates market risk to the FHLBank and credit risk to both the member or housing associate and the FHLBank on a shared basis.

The AMA mortgage programs provide greater flexibility and liquidity to FHLBank members by providing a lender with another option in addition to holding the loan in portfolio or selling it in the secondary market. The AMA single-family mortgage purchase programs introduce greater flexibility in mortgage financing and can potentially lower the cost of mortgage finance.

To assure consistency with the FHLBanks' mission, the Finance Board's regulation governing AMA prescribes the type of assets and manner in which the FHLBanks may purchase assets under the AMA programs, among other features. The FHLBanks' practices are reviewed as a part of annual examinations as well as monitored off-site. The AMA regulation requires the FHLBanks periodically to report specific information to the Finance Board, which uses the data to evaluate the contribution of AMA to housing finance. This information includes certain data such as the geographic distribution of loans and demographic characteristics of borrowers.

As the FHLBanks develop additional AMA products, the Finance Board will monitor those products for consistency with the FHLBanks' mission, the responsiveness of the products to member needs, and the effectiveness of alternative AMA structures in supporting the nation's housing finance system. The Finance Board will also collect and analyze demographic and other information on the AMA programs at least annually and compare the performance of AMA loans against similar products of other financial intermediaries. Where a FHLBank proposes to conduct an AMA activity or acquire an AMA program asset entailing new risk for the institution, the FHLBank is required to submit a new business activity notice to the agency before the initiation of the activity or acquisition of the asset. In its review of such notices, the agency considers safety and soundness implications of the proposal, product compliance with law and regulation, product responsiveness to member needs, and product effectiveness in supporting the nation's housing finance system.

## **Strategic Objective 2.2: The Federal Home Loan Banks Support Affordable Housing and Promote Community Investment.**

### **Means and Strategies:**

#### **2.2.1. Carry Out Effective Affordable Housing Program (“AHP”) Examinations.**

- Examine annually each FHLBank’s AHP for compliance with applicable statutes and regulations.
- Assess the effectiveness of each FHLBank’s AHP.
- Assess AHP for consistency with law, regulation, and responsiveness to the needs of members and affordable housing stakeholders.
- Enhance information systems for reviewing the uses of AHP funds.

#### **2.2.2. Facilitate Innovative Opportunities for Each FHLBank to Expand Its Affordable Housing and Community Investment Activities.**

- Revise regulations to address new community investment opportunities and enhance the Affordable Housing and Community Investment Programs’ effectiveness.
- Review the FHLBanks’ community lending plans and FHLBank members’ community support statements.
- Carry out statutory duty to appoint public interest directors, including community interest directors, to each FHLBank’s board of directors.

AHP subsidies are either grants or below-market rate advances given to members for a specific approved project in support of affordable housing targeted to very low-, low-, and moderate-income households. By statute, each FHLBank annually must contribute in support of affordable housing ten percent of its net income for the previous year or, if greater, the *pro rata* share of an aggregate contribution for the twelve FHLBank of at least \$100 million. The ten percent of income provision has determined actual contributions since 1995 and is expected to continue to do so. Each FHLBank administers its own AHP.

AHP funds can be used to finance: (i) the purchase of homes by households with incomes at or below eighty percent of the area median income; and (ii) the purchase, construction, or rehabilitation of rental housing in which at least twenty percent of the units are occupied by and affordable to very-low income households. As of June 30, 2004, the FHLBanks contributed approximately \$2 billion in program funding to assist in the financing of more than 375,000 units of housing.

As part of the annual examination, Finance Board examiners review each FHLBank’s AHP. The examination includes a review of: (i) policies, procedures, and controls including accounting

and funds reconciliation; (ii) board and management oversight; and (iii) award processes and use of funds to assure adherence to statutory and regulatory requirements. To assess compliance with program regulations, the Finance Board reviews a sample of projects. The Finance Board intends to enhance data information systems to improve tracking of program performance.

To identify effective practices in the AHP, the Finance Board has sponsored community development workshops with AHP stakeholders. In addition, the Finance Board recently conducted a review of the AHP for all FHLBanks. The Finance Board expects to issue a report addressing the efficacy of AHP programs in promoting affordable housing based upon findings in the horizontal review and other sources.

Under the FHLBank Act, the FHLBanks must establish a Community Investment Program (“CIP”) that provides advances to members at the cost of funds plus reasonable administrative costs. Members can use these funds to: (i) finance home purchases by families whose income does not exceed 115 percent of the median income for the area; (ii) finance purchase or rehabilitation of housing for occupancy by families whose income does not exceed 115 percent of median income for the area; and (iii) finance commercial and economic development activities that benefit low- and moderate-income families or activities that are located in low- and moderate-income neighborhoods.

In addition, the statute encourages the development of other FHLBank advance programs to benefit low- and moderate-income communities. The Finance Board has promulgated regulations that permit the FHLBanks to voluntarily issue Community Investment Cash Advances (“CICA”) that support targeted community lending for eligible beneficiaries. CICA loans and grants are used in underserved markets as well as to support a variety of revitalization efforts and expansion in growing markets. The CIP and other CICA programs are reviewed annually as part of each FHLBank’s examination to assess whether the FHLBank’s policies and practices meet the CIP and CICA targeting criteria.

Finance Board regulations require each FHLBank to adopt an annual community lending plan that requires the institution to: (i) conduct market research in its district; (ii) describe the manner in which it will address identified credit needs and market opportunities in the district for targeted community leading; (iii) consult with its advisory council and its members, housing associates, and public and private economic development organizations in its district in developing an implementing the plan; and (iv) establish quantitative community lending performance goals for that year. Each year the Finance Board will review the community lending plan for each FHLBank and assess the plan’s adherence to the requirements of the agency’s regulations.

Finance Board regulations also mandate the solicitation and review by the Finance Board of the community support statement of an FHLBank member approximately once every two years through a notification and review procedure prescribed in the regulations. In its consideration of a member’s community support statement, the agency will take into account a member’s performance under the Community Reinvestment Act of 1977 if the institution is subject to that act, and its record of lending to first-time homebuyers. The agency generally acts on each community support statement within seventy-five days of the date it deems the statement to be complete, and thereafter provides a written notice to the member and its FHLBank as to its determination, together with its reason for such action.

The FHLBank Act specifies that the board of directors of each FHLBank be comprised, generally, of eight directors elected by the institution’s members and six directors appointed by the

Finance Board. At least two of the directors of each FHLBank appointed by the Finance Board are required to be chosen from organizations with more than a two-year history of representing consumer or community interests on banking services, credit needs, housing, or financial consumer protections. The agency appoints or reappoints qualified public interest directors, including community interest directors, each calendar year, to fill vacancies occurring on the board of directors of each FHLBank.

### **STRATEGIC GOAL 3: The Federal Housing Finance Board's Supervisory, Managerial, and Legal Resources Support Effective, Efficient, and Responsive Bank Supervision and Regulation and Housing Mission Oversight.**

<b>Strategic Objective 3.1: The Finance Board Takes Appropriate and Timely Regulatory and Advisory Actions.</b>
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#### **Means and Strategies:**

##### **3.1.1. Review, Revise, and Supplement Finance Board Regulations to Ensure Relevance and Transparency.**

- Conduct review of Finance Board regulations and revise and supplement these where appropriate.
- Evaluate regulations and guidance of other financial institution regulators as a benchmarking tool.

##### **3.1.3. Review and Act on Notifications of New Business Activities from the FHLBanks.**

- Assess new business activity notices for legal compliance and safety and soundness implications.
- Respond to FHLBanks on new business activity notices within sixty days of receipt.
- Review implementation of all new business activities as part of supervisory activities.

##### **3.1.2. Issue Results-Oriented Supervisory Guidance that Effectively Anticipates and Addresses Challenges to the FHLBanks and OF.**

- Evaluate emerging issues encountered or reported by the FHLBanks and OF.
- Disseminate supervisory guidance responsive to the challenges faced by the FHLBanks and OF.
- Collaborate with other financial institution regulators on issues affecting the respective regulated entities.

The Finance Board reviews its regulations to ensure the consistency of these with the agency's risk-focused regulatory and supervisory program and priorities. Such review also ensures that the regulations provide specific guidance while remaining sufficiently flexible to allow the Finance Board to adapt in response to changing conditions and revise and eliminate provisions that are no longer relevant or effective, do not achieve their intended purpose, are unreasonably burdensome, or are complex or ambiguous. The Finance Board will continue to identify and adopt effective practices in regulatory supervision and will work with other financial institution regulators to identify the most effective supervisory practices.

The Finance Board develops and issues anticipatory, results-oriented supervisory guidance to the FHLBanks. Timely guidance is provided in response to the evolving activities and operations of the FHLBanks, developments in the financial markets, and recently identified supervisory issues and best practices. In this connection, the agency identifies and incorporates effective practices in regulatory supervision into its supervisory guidance and is working with other financial institution regulators to identify such practices.

The Finance Board requires an FHLBank to provide notice of certain proposed new business activities. Based on the information provided by the FHLBank, the Finance Board will assess whether the proposed new business activity is legally permissible and whether the FHLBank has the capacity to manage the risks inherent with the activity. If a new business activity is found to be appropriate for a particular FHLBank, the Finance Board will approve the activity with such conditions as may be appropriate and will endeavor to transmit an appropriate notification to the FHLBank of its action within sixty days of the agency's receipt of the institution's new business activity notice. Alternatively, the agency may issue a notice or provide other communication to the FHLBank disapproving the activity, instructing it not to commence the activity pending further agency consideration, declaring an intent to examine it, requesting additional information, establishing agency conditions to approval of the activity, or containing other instructions or information deemed appropriate by the agency, within that timeframe. As a part of the on-going supervisory review of new business activities, an assessment of the FHLBank's implementation of a new activity is conducted, often as a part of the next on-site examination.

<p><b>Strategic Objective 3.2: The Finance Board Makes Prudent Resource Management Allocations in Order to Fulfill Its Mission Effectively and Efficiently.</b></p>
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**Means and Strategies:**

**3.2.1. Recruit, Retain, and Develop Highly Skilled and Dedicated Staff.**

- Target recruitment activities to reach diverse, high caliber applicants.
- Encourage the development of staff skills and abilities to support the mission of the Finance Board.
- Foster a more effective and responsive EEO program.

### **3.2.2. Enhance Finance Board Infrastructure to Facilitate Achievement of Strategic Goals.**

- Enhance information technology platform and applications.
- Implement an information security program that complies with the Federal Information Security Management Act.
- Assure that resource allocation by the Finance Board is designed and operated to assure that resources are aligned with the mission and strategic plan of the Finance Board.

### **3.2.3. Maintain Appropriate Contingency Planning and Business Continuity Plan.**

- Review and update annually the Finance Board's business continuity plan.
- Test annually the Finance Board's business continuity plan.
- Participate in the interagency committee addressing threats to the nation's financial infrastructure from physical and cyber terrorism.

Maintaining a workplace that cultivates professional staff, uses superior technology, and promotes contingency planning is instrumental to the Finance Board's success as a federal banking regulator. The Finance Board is committed to ensuring the highest professional standards of accountability and independence for the agency and its staff.

With additional complexities in the FHLBanks' activities, new challenges are facing the Finance Board and must be met with highly skilled and engaged staff. The Finance Board addresses staffing needs to ensure its mission is effectively carried out consistent with the highest professional standards. Recruitment of high-achieving professionals to fill examiner, economist, accountant, and mortgage, risk, financial, and policy specialist and analyst vacancies will remain a priority. To facilitate integration of new staff, an orientation program will be instituted so that new hires are provided with a general understanding of the System. To encourage staff engagement, the Finance Board has instituted a recognition program to reward superior achievement. The Finance Board is also enhancing its minority recruitment program to reach out to under-represented groups through less traditional means, such as through minority professional associations.

The Finance Board's efforts to technologically enhance the agency's work environment will create greater efficiency and effectiveness. Information Technology ("IT") systems are being re-engineered to accommodate future data management and collection needs and provide the agency with an integrated data information and management system, including enhanced electronic and paper document systems. In addition, enhanced budget and program integration is underway. To enhance efficiency and cost effectiveness of the IT function, the Finance Board has recently outsourced its infrastructure support and will monitor outside contractors to assure optimal delivery.

The heightened security risks that continue to be present in the Washington, D.C. area accentuate the importance of a well-conceived and routinely tested business continuity plan. The

Finance Board is committed to maintaining a sound contingency plan, consulting with other federal agencies, and conducting regular testing so that in the event of a crisis, the Finance Board is prepared to successfully execute an emergency plan with as little disruption as possible to agency operations.